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Financial Markets

Irving Trust

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(Noon)

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If the financial markets were jolted by the money supply number released two weeks ago, they were stunned by last week's $7.1 billion increase. Surging M1 growth is widely believed to be the result of later-than-usual tax refunds, languishing as deposits in the transactions components of the monetary aggregates. This has prompted some criticism of the Fed's (faulty) seasonal factors, a view that is appealing, but not reassuring. April's strong seasonal factors were designed to flatten the "usual" April money bulge. If instead it's true that the real surge in money is coming later this year, it's also true that April's seasonals were too strong--this in turn means that, properly adjusted, money growth should have been measured as even stronger in April. This is why the "faulty seasonal" argument does not satisfy. How strong is true money growth? Does the Fed care?

Nothing that I am aware of can explain away the strength of money growth. Arguments based on faulty seasonals suffice (by definition) to bring M1 inside the growth range, but only for the time being. Consistency requires the substitution of stronger (growth-raising) seasonals later in the year. It is this aspect of seasonality that must not be forgotten: Seasonality neither creates nor destroys money--it just redistributes. Therefore, it appears to me that the Fed is facing a fundamental problem in money demand, not some technical aberration.

The theoretical problem, to an economist, concerns the recent behavior of the money demand function. This is a statistical relationship that describes the money balances held by the public in terms of income, interest rates, and, sometimes, other factors. If this relationship has undergone some permanent shift, the Fed will (and should) miss its monetary targets this year. On the other hand, money demand relationships are notorious for their short-term instabilities; if the current shift (instability) in money demand is temporary, the Fed will have to counterbalance its current money-pumping operation when money demand shifts back. The current debate among economists thus can be seen as choosing sides on the temporary-permanent issue. The good news is that this debate can be settled. The bad news is that it will be settled by economic historians!

The FOMC has no such luxury. It must make policy today. The committee's recognition of the money demand problem is reflected in statements concerning the velocity of M1 (this is just another way to summarize the money demand problem). In spite of the erratic behavior in M1's velocity, the Fed will, in all likelihood, stick with M1 and an M1 target. This is the aggregate closest to the concept of money that economists ponder on chalkboards. Unless the Board of Governors' staff can isolate reasons for M1's strong growth, the intellectual attachment to M1 will probably carry the day and lead the Fed to react to M1 at some point. For now, the Fed is looking straight through its intermediate targets (M1, M2, M3) to focus on the economy. But as the strength of economic recovery is realized, the Fed will come to look more and more closely at all its intermediate targets, including M1. The pragmatic policy that has characterized the Fed so far this year will be tested by criticism from the usual core of monetarists; their ranks will swell as the money growth problem endures or worsens.

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Market Yields

	5/27/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.50	8.63	13.38
Repurchase Agreements	8.13	8.50	11.88
U.S. Treasury Issues			
Bills			
3 months	8.74	8.43	12.00
6 months	9.01	8.70	12.52
1 year	9.23	8.96	12.89
Coupons			
2 years	9.86	9.58	13.71
4 years	10.18	9.98	13.76
7 years	10.54	10.39	13.81
10 years	10.58	10.48	13.67
Long Bond	10.74	10.64	13.33
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.65	8.55	13.38
3 months	8.80	8.60	13.38
6 months	9.10	8.75	13.50
1 year	9.40	9.15	13.50
Banker's Acceptances			
1 month	8.66	8.46	13.25
3 months	8.85	8.63	13.35
6 months	9.10	8.79	13.60
Eurodollar Deposits			
1 month	9.06	8.94	14.25
2 months	9.13	9.00	14.38
3 months	9.25	9.13	14.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	8.51	13.21
1 month	8.68	8.56	13.58
3 months	8.81	8.68	13.62
Bank Holding Companies			
1 month	8.30	8.56	13.20
Dealer Placed:			
3 months	8.89	8.66	14.04
New AA Corporate Utility Bond	11.65	11.40	15.95
Tax Exempt			
6 month Project Notes	4.75	4.75	7.40
1 year AAA Bond	5.50	5.25	7.75
5 year AAA Bond	7.00	6.60	9.00
20 year AAA Bond	9.10	8.50	11.50

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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